

Sierra Metals Inc.

Positive Operational Updates in Mexico

OUR TAKE: SMT released a positive update for its two Mexican assets, with operational improvements tracking slightly ahead of our expectations. We rate SMT SO based on solid organic growth potential, its strong financial position, and our robust FCF outlook. Our revised 12-month target of C\$4.25 per share (from C\$4.00) is based on a 50/50 mix of 4.5x our average 2018E/19E EV/EBITDA and 1.0x our NAVPS estimate.

KEY POINTS

High grade ore to fill Cusi mill by Q2/18. SMT expects high-grade ore from the Santa Rosa de Lima zone to largely fill the 650 tpd mill by Q2/18, one quarter faster than our previous estimates, which we view as positive. We anticipate an updated NI 43-101 technical report in Q4/17 to provide additional colour on the nature of this production growth (particularly with respect to head grades), and should serve as a meaningful catalyst for SMT. In addition, SMT announced that Cusi's Ag recoveries have improved from the ~65% level in H1/17 to an average level of 83% from August to October 2017. While our previous estimates had assumed a LT recovery improvement to the ~80% level, the pace of recovery has been faster than we had expected.

Bolivar Cu recoveries, throughput ahead of expectations. Cu recoveries have improved to an average level of 82% from Q2/17 levels of 76% due to refinements in the grind size of milled ore. Similar to Cusi, the recovery improvement is in line with our previous LT estimates of 81% but the pace of improvement has exceeded our expectations. SMT also announced that Bolivar mill throughput is expected to reach 3ktpd in Q1/18, slightly ahead of our prior estimates which assumed 2018 average throughput of 2.8ktpd. Higher-grade Bolivar W and NW ore is expected to contribute by H2/19, in line with our estimates.

Expansion plans increasingly in focus. At Cusi, SMT continues to study a mill expansion and the results of a prefeasibility study are expected by Q3/18. Our estimates currently assume SMT expands Cusi's milling capacity to 2ktpd in 2022 at a capital cost of \$85M. SMT also plans to release an expansion study for Bolivar by Q3/18; our estimates do not currently assume a Bolivar expansion.

Positive estimate revisions. Our 2018E and 2019E EBITDA forecasts of \$135M and \$157M increased an average of 4% due to higher throughput and recovery assumptions at both assets. Our NAVPS increased 3% to C\$3.88.

Qtly Adj EPS (FD)	Q1	Q2	Q3	Q4	Year
2016A	\$-0.01	\$0.00	\$0.03	\$0.02	\$0.04
2017E	\$0.07A	\$0.03A	\$0.02	\$0.03	\$0.15
2018E	\$0.05	\$0.06	\$0.06	\$0.06	\$0.22
2019E	\$0.07	\$0.07	\$0.07	\$0.07	\$0.27

(FY-Dec.)	2016A	2017E	2018E	2019E
CFPS	\$0.25	\$0.43	\$0.70	\$0.66
FCFPS	\$0.11	\$0.15	\$0.47	\$0.36
Revenues (M)	\$143	\$214	\$253	\$277
EBITDA (M)	\$42	\$95	\$135	\$157
Silver Equivalent Production	12	11	13	13
Silver Cash Cost (US\$/oz)	\$8.13	\$9.06	\$8.12	\$7.98
All-In Sustaining Cost (\$/oz)	\$14	\$16	\$14	\$14

Historical price multiple calculations use FYE prices. All values in US\$ unless otherwise indicated. Source: FactSet; company reports; Scotiabank GBM estimates.

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ANALYST TEAM

[Link to ScotiaView](#)

METALS & MINING

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PERTINENT DATA

Rating	Sector Outperform
1-Yr. Target	C\$4.25
SMT-T	C\$3.11
1-Yr. Return	36.7%
Div. (NTM)	\$0.00
Div. (Curr.)	\$0.00
Yield (Curr.)	0.0%
NAVPS	C\$3.88
P/NAV	0.80x

Valuation: 50/50 weighting of 4.5x average 2018E/2019E EV/EBITDA and 1.0x NAVPS

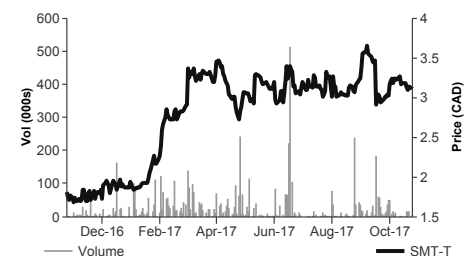
PERTINENT REVISIONS

	New	Old
1-Yr. Target	C\$4.25	C\$4.00
Adj EPS18E	\$0.22	\$0.20
NAVPS	C\$3.88	C\$3.78

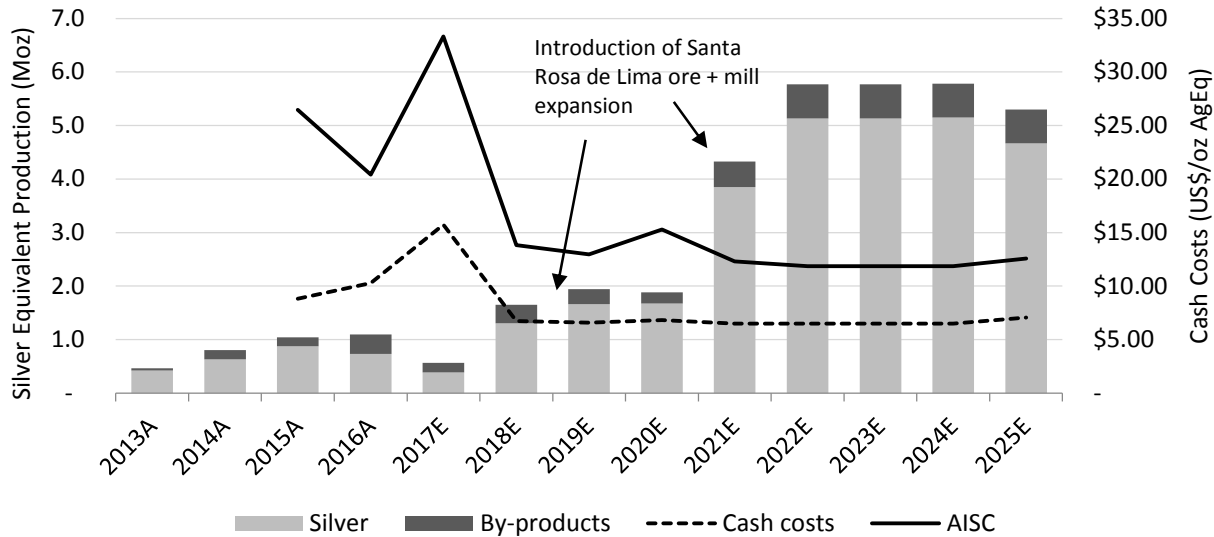
CAPITALIZATION

Market Cap. (M)	C\$506
Net Debt + Pref. (M)	C\$81
Enterprise Value (M)	C\$587
Shares O/S (M)	163
Float O/S (M)	52

Volume and Closing Price for SMT-T

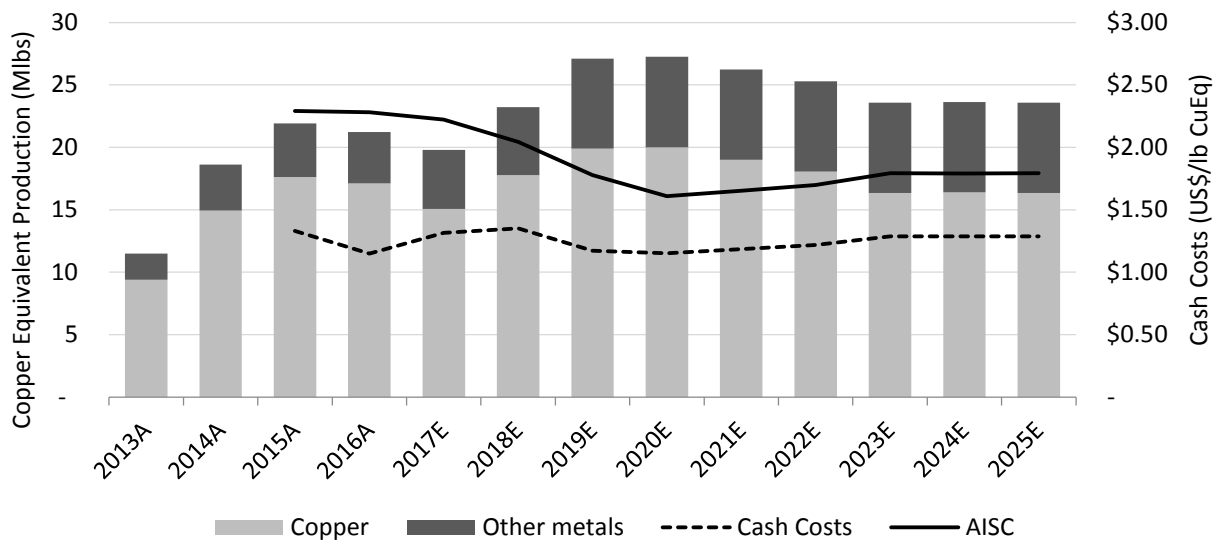


Source: FactSet.

Exhibit 1: Revised Cusi Silver Equivalent Production and Cash Cost Outlook


Note: Forecast period assumes SMT's equivalent prices of: \$19.50/oz Ag, \$2.28/lb Cu, \$0.85/lb Pb, \$1.05/lb Zn, and \$1,369/oz Au.

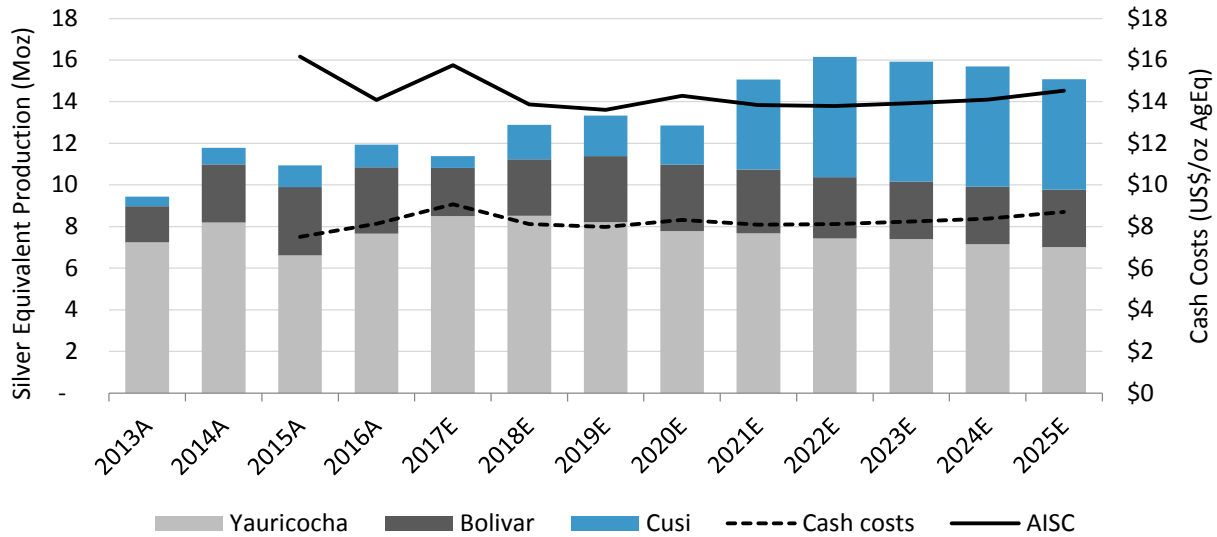
Source: Company reports; Scotiabank GBM estimates.

Exhibit 2: Revised Bolivar Copper Equivalent Production and Cash Cost Outlook


Note: Forecast period assumes SMT's equivalent prices of: \$19.50/oz Ag, \$2.28/lb Cu, \$0.85/lb Pb, \$1.05/lb Zn, and \$1,369/oz Au.

Source: Company reports; Scotiabank GBM estimates.

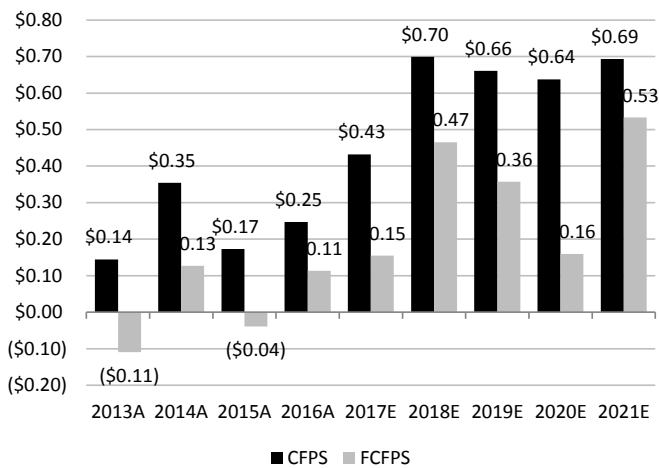
Exhibit 3: SMT Silver Equivalent Production and Cash Cost Outlook



Note: Forecast period assumes SMT's silver equivalent prices of: \$19.50/oz Ag, \$2.28/lb Cu, \$0.85/lb Pb, \$1.05/lb Zn, and \$1,369/oz Au.

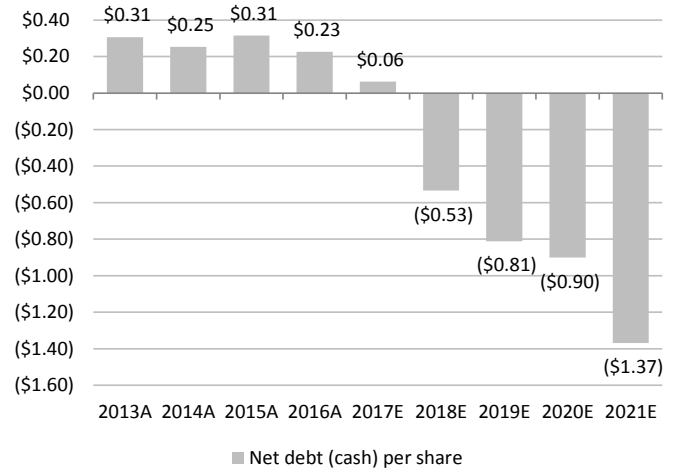
Source: Company reports; Scotiabank GBM estimates.

Exhibit 4: CFPS and FCFPS Forecast

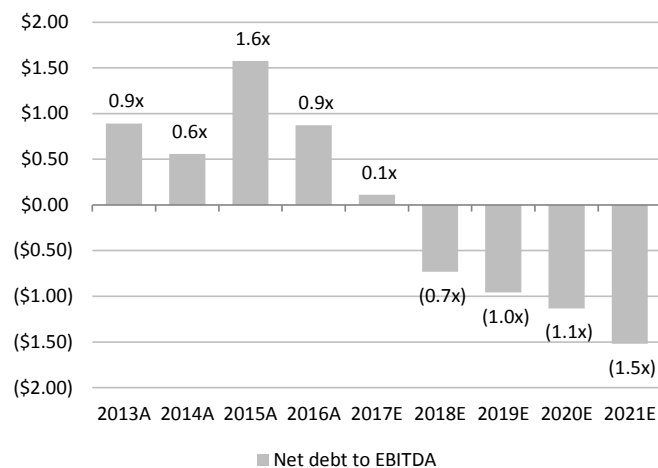


Source: Company reports; Scotiabank GBM estimates.

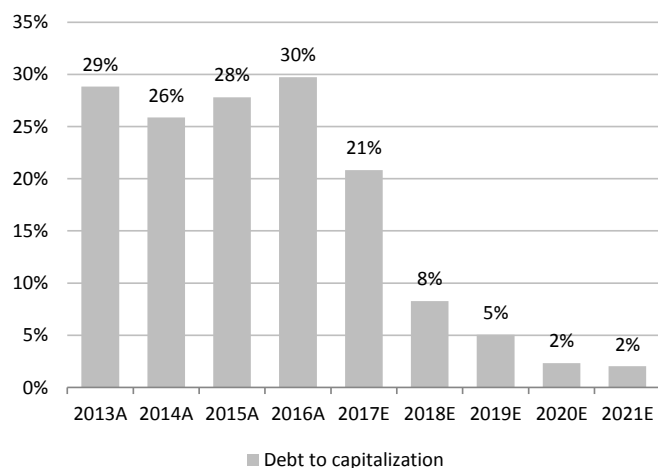
Exhibit 5: Net Debt per Share Forecast



Source: Company reports; Scotiabank GBM estimates.

Exhibit 6: Net Debt to EBITDA Forecast


Source: Company reports; Scotiabank GBM estimates.

Exhibit 7: Debt to Capitalization Forecast


Source: Company reports; Scotiabank GBM estimates.

Exhibit 8: Forecast Sensitivities to a +10% Change in Metal Prices

	Base Case Metal Prices					Base Case Estimates			
	2017E	2018E	2019E	2020E		2017E	2018E	2019E	2020E
Silver (\$/oz)	\$17.14	\$18.50	\$20.00	\$20.00	EBITDA (\$mm)	95	135	157	147
Zinc (\$/lb)	\$1.31	\$1.50	\$1.60	\$1.50	EPS (\$/sh)	\$0.15	\$0.22	\$0.27	\$0.26
Copper (\$/lb)	\$2.77	\$2.85	\$3.00	\$3.25	CFPS (\$/sh)	\$0.43	\$0.70	\$0.66	\$0.64
Lead (\$/lb)	\$1.04	\$1.10	\$1.20	\$1.20	NAV (C\$/sh)	C\$3.88			
	Silver Price +10%					Zinc Price +10%			
	2017E	2018E	2019E	2020E		2017E	2018E	2019E	2020E
EBITDA	2%	4%	5%	5%	EBITDA	4%	5%	4%	4%
EPS	4%	9%	8%	8%	EPS	8%	10%	7%	6%
CFPS	2%	3%	4%	4%	CFPS	4%	3%	4%	3%
NAV	9%				NAV	4%			
	Copper Price +10%					Lead Price +10%			
	2017E	2018E	2019E	2020E		2017E	2018E	2019E	2020E
EBITDA	4%	6%	6%	8%	EBITDA	1%	3%	2%	2%
EPS	9%	12%	11%	14%	EPS	3%	5%	4%	2%
CFPS	4%	3%	5%	6%	CFPS	1%	2%	2%	1%
NAV	10%				NAV	2%			

Source: Scotiabank GBM estimates.

Exhibit 9: Sierra Metals NAV Breakdown (as at year-end 2017)

(in millions except as noted)	USD		CAD		CAD 8%		
	10%	8%	10%	8%	C\$/sh	% Op. NAV	% of NAV
Yauricocha	361	397	435	478	\$2.58	68%	66%
Bolivar	104	116	126	140	0.75	20%	19%
Cusi	57	70	68	84	0.45	12%	12%
Operating assets	523	582	630	702	\$3.79	100%	98%
Corporate adjustments							
Cash	86	86	103	103	0.56		14%
Non-cash working capital	1	1	2	2	0.01		0%
Attributable debt	(51)	(51)	(62)	(62)	(0.33)		(9%)
Corporate SG&A	(35)	(39)	(42)	(47)	(0.26)		(7%)
Closure / reclamation	(14)	(14)	(16)	(16)	(0.09)		(2%)
Corporate tax adj.	30	32	36	38	0.21		5%
Net asset value	539	597	650	719	\$3.88		100%

Fully diluted shares outstanding 185

Net asset value per share	\$2.91	\$3.22	\$3.51	\$3.88
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NAV assumes long-term prices of \$20/oz Ag, \$1.00/lb Zn, \$3.00/lb Cu, \$0.95/lb Pb, starting 2022. Base case Cusi NAV discounted at 5% to reflect precious metals as primary source of revenue.

Source: Company reports; Scotiabank GBM estimates.

Exhibit 10: Sierra Metals Operating and Financial Outlook

	<< In CAD Pre-2013											Annual Growth Profile		
	2011A	2012A	2013A	2014A	2015A	2016A	2017E	2018E	2019E	2020E	2021E	2017E	2018E	2019E
METAL PRICE FORECAST														
Silver (US\$/oz)	\$35.31	\$31.16	\$23.91	\$20.18	\$15.73	\$17.10	\$17.14	\$18.50	\$20.00	\$20.00	\$20.00	0%	8%	8%
Copper (US\$/lb)	\$4.00	\$3.61	\$3.33	\$3.18	\$2.50	\$2.21	\$2.77	\$2.85	\$3.00	\$3.25	\$3.50	26%	3%	5%
Lead (US\$/lb)	\$1.09	\$0.93	\$0.97	\$0.96	\$0.81	\$0.84	\$1.04	\$1.10	\$1.20	\$1.20	\$1.10	24%	6%	9%
Zinc (US\$/lb)	\$1.00	\$0.88	\$0.87	\$0.94	\$0.88	\$0.95	\$1.31	\$1.50	\$1.60	\$1.50	\$1.35	39%	14%	7%
PRODUCTION FORECAST														
Silver (Moz)	2.4	2.6	2.6	3.1	3.1	3.0	2.4	3.6	4.1	3.9	5.9	(18%)	49%	11%
Copper (Mlbs)	16.3	15.9	15.9	22.6	23.2	23.4	26.1	27.5	31.5	37.7	39.7	12%	5%	14%
Lead (Mlbs)	32.9	35.7	38.0	48.8	42.2	40.6	31.4	34.7	30.5	20.0	19.7	(23%)	11%	(12%)
Zinc (Mlbs)	48.7	59.0	51.7	54.3	42.1	56.6	75.2	73.4	65.3	55.2	54.5	33%	(2%)	(11%)
Silver equivalent (Moz)	n/a	n/a	9.4	11.8	10.9	11.9	11.4	12.9	13.3	12.9	15.1	(5%)	13%	3%
Copper equivalent (Mlbs)	n/a	n/a	62.9	78.6	72.9	79.4	97.3	110.2	114.0	110.0	128.8	23%	13%	3%
UNIT COST FORECAST														
Yauricocha (US\$/t)	\$50.09	\$58.02	\$52.30	\$45.94	\$52.88	\$55.76	\$60.74	\$58.25	\$58.00	\$58.00	\$58.00	9%	(4%)	(0%)
Bolivar (US\$/lb, CuEq)	\$1.18	\$1.40	\$1.28	\$1.28	\$1.33	\$1.15	\$1.32	\$1.35	\$1.17	\$1.15	\$1.18	14%	3%	(13%)
Cusi (US\$/oz, AgEq)	-	-	\$11.52	\$8.07	\$8.82	\$10.28	\$15.73	\$6.73	\$6.57	\$6.82	\$6.48	53%	(57%)	(2%)
AgEq Cash Costs (US\$/oz)	n/a	n/a	n/a	n/a	\$7.50	\$8.13	\$9.06	\$8.12	\$7.98	\$8.32	\$8.09	11%	(10%)	(2%)
AgEq AISC (US\$/oz)	n/a	n/a	n/a	n/a	\$16.17	\$14.08	\$15.75	\$13.86	\$13.61	\$14.28	\$13.84	12%	(12%)	(2%)
INCOME STATEMENT (US\$MM)														
Revenue	101	180	144	173	134	143	214	253	277	266	301	49%	18%	9%
Cash cost of sales	(41)	(71)	(69)	(73)	(80)	(82)	(96)	(93)	(94)	(95)	(108)	17%	(3%)	2%
Selling, general & admin	(17)	(24)	(22)	(25)	(21)	(22)	(23)	(22)	(23)	(23)	(24)	4%	(1%)	2%
Exploration & Other	1	(1)	2	(2)	(1)	2	(1)	(3)	(3)	(2)	(2)	(131%)	nm	(0%)
EBITDA	45	84	55	73	32	42	95	135	157	147	167	126%	43%	16%
Depreciation & amortization	(53)	(92)	(78)	(50)	(47)	(45)	(65)	(62)	(65)	(61)	(65)	45%	(4%)	4%
Interest expense	(5)	(8)	(5)	(5)	(5)	(4)	(3)	(2)	(1)	(0)	(0)	(6%)	(44%)	(59%)
Other	(5)	(0)	(12)	(3)	(19)	(1)	(3)	-	-	-	-	nm	(100%)	-
Income taxes	(2)	(10)	3	(3)	3	(6)	(10)	(25)	(32)	(30)	(36)	73%	150%	28%
Non-controlling interest	0	2	4	(2)	2	0	(5)	(8)	(8)	(7)	(7)	nm	72%	7%
Reported net income	(20)	(26)	(34)	9	(33)	(12)	9	38	51	49	59	(173%)	nm	32%
Adjusted net income	(20)	48	30	30	4	7	24	38	51	49	59	nm	58%	32%
Adjusted EPS (\$/sh)	(\$0.17)	\$0.32	\$0.19	\$0.19	\$0.03	\$0.04	\$0.15	\$0.22	\$0.27	\$0.26	\$0.32	nm	45%	27%
Shares (mm)	116	151	158	159	161	162	163	177	185	185	185	1%	9%	4%
CASH FLOW STATEMENT (US\$MM)														
Net earnings	(20)	(28)	(38)	11	(35)	(13)	13	46	59	56	66	nm	nm	28%
Depreciation & amortization	53	93	79	51	47	46	65	62	65	61	65	42%	(4%)	4%
Other	8	(7)	(14)	(2)	20	11	(5)	17	(1)	2	(2)	(145%)	nm	(105%)
Cash from operations	42	58	27	60	31	44	73	126	123	119	129	68%	71%	(2%)
CFPS	\$0.36	\$0.35	\$0.14	\$0.35	\$0.17	\$0.25	\$0.43	\$0.70	\$0.66	\$0.64	\$0.69	75%	62%	(6%)
Sustaining capex	(5)	(8)	(13)	(24)	(25)	(20)	(25)	(25)	(23)	(23)	(23)	29%	1%	(2%)
Growth capex	(19)	(19)	(31)	(16)	(12)	(6)	(23)	(18)	(32)	(67)	(8)	nm	(23%)	80%
Free cash flow to the firm	18	31	(17)	20	(6)	18	25	83	66	30	99	38%	nm	(20%)
FCFF per share	\$0.15	\$0.20	(\$0.11)	\$0.13	(\$0.04)	\$0.11	\$0.15	\$0.47	\$0.36	\$0.16	\$0.53	37%	nm	(23%)
Debt issued (repurchased)	97	(25)	4	(11)	(5)	3	(26)	(29)	(8)	(9)	-	nm	10%	(73%)
Dividends to NCI	-	-	(9)	(7)	(1)	(0)	(8)	(14)	(14)	(12)	(12)	nm	74%	3%
Free cash flow to equity	115	5	(22)	2	(12)	21	(9)	40	44	9	87	(141%)	nm	10%
FCFE per share	\$0.99	\$0.03	(\$0.14)	\$0.01	(\$0.07)	\$0.13	(\$0.05)	\$0.23	\$0.24	\$0.05	\$0.47	(141%)	nm	6%
Equity issued (repurchased)	148	45	(1)	0	-	-	13	42	-	-	-	-	nm	(100%)
Dividends to SMT shareholders	(9)	(6)	(7)	(1)	-	-	-	-	-	-	-	-	-	-
Other sources (uses) of cash	(249)	16	(5)	(4)	(4)	(4)	(3)	(2)	(1)	(0)	(0)	(31%)	(38%)	(49%)
Net sources (uses) of cash	5	60	(35)	(4)	(16)	17	1	81	43	8	87	(94%)	nm	(46%)
BALANCE SHEET (US\$MM)														
Cash and equivalents	20	80	45	41	25	42	43	124	167	176	262	2%	187%	35%
Other current assets	90	47	51	52	37	40	48	52	55	53	60	19%	9%	4%
Current assets	111	127	96	93	62	82	91	177	222	229	323	11%	93%	26%
PP&E	440	378	344	330	302	282	267	249	241	269	234	(5%)	(7%)	(3%)
Other assets	-	0	2	1	4	1	1	1	1	1	1	124%	0%	0%
Total assets	551	505	441	424	369	365	360	426	464	499	558	(1%)	18%	9%
Current liabilities (ex-debt, AROs)	47	31	26	36	29	42	47	47	47	47	52	12%	0%	0%
Debt	116	89	94	82	76	79	54	25	17	9	9	(32%)	(53%)	(32%)
Decommissioning liability	11	12	16	15	14	14	14	13	13	13	13	(2%)	(3%)	(3%)
Other liabilities	105	90	75	57	51	45	41	61	62	62	62	(8%)	49%	1%
Total liabilities	279	222	210	190	171	179	155	147	139	131	136	(13%)	(6%)	(5%)
Shareholders' equity	216	237	196	205	171	160	182	263	314	363	422	14%	44%	19%
Non-controlling interest	56	46	35	30	27	26	22	17	11	6	1	(13%)	(26%)	(34%)
Total liabilities & shareholders' equity	551	505	441	424	369	365	360	426	464	499	558	(1%)	18%	9%

Source: Company reports; Scotiabank GBM estimates.

Company Overview

Company Description

Sierra Metals Inc. is a mining company that produces, develops, and explores a variety of base and precious metals assets in Peru and Mexico. The company holds an 82% interest in the Yauricocha polymetallic mine, a 100% interest in the Bolivar copper mine, and a 100% interest in the Cusi silver mine.

Risks

Key Risks: Commodity price, resource conversion, operating and technical risks, limited common share liquidity

Total Return Index of SMT-T



Source: Scotiabank GBM; FactSet.

Appendix A: Important Disclosures

Company	Disclosures (see legend below)*
Sierra Metals Inc.	VS0479, VS0480, VS0481

I, Ian Grundy, certify that (1) the views expressed in this report in connection with securities or issuers that I analyze accurately reflect my personal views and (2) no part of my compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed by me in this report.

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*Legend

- VS0479** Research Associate Ian Grundy visited Bolivar, an operating copper mine in Chihuahua, Mexico on August 10, 2017. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Associate to visit this site.
- VS0480** Research Associate Ian Grundy visited Yauricocha, a Polymetallic Zn-Cu-Pb-Ag mine in Yauyos Province, Peru on August 7-8, 2017. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Associate to visit this site.
- VS0481** Research Associate Ian Grundy visited Cusi, an operating silver mine in Chihuahua, Mexico on August 9, 2017. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Associate to visit this site.

Rating and Price Target History

Sierra Metals Inc. (SMT-T) as of October 23, 2017 (in CAD)

30-Aug-2017 Price: 3.25 Rating: I:SO Target: 4.00	29-Sep-2017 Price: 3.15 Rating: SO Target: 4.25*	03-Oct-2017 Price: 3.18 Rating: SO Target: 4.00*
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*Represents the value(s) that changed.

Powered by: BlueMatrix

Ratings Legend: FS=Focus Stock; SO=Sector Outperform; SP=Sector Perform; SU=Sector Underperform; T=Tender; UR=Under Review; CS=Coverage Suspended; DC=Discontinued Coverage
Source: Scotiabank GBM estimates/Scotia Howard Weil estimates; FactSet.

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The rating assigned to each security covered in this report is based on the Scotiabank, Global Banking and Markets research analyst's 12-month view on the security. Analysts may sometimes express to traders, salespeople and certain clients their shorter-term views on these securities that differ from their 12-month view due to several factors, including but not limited to the inherent volatility of the marketplace.

Ratings

Focus Stock (FS)

The stock represents an analyst's best idea(s); stocks in this category are expected to significantly outperform the average 12-month total return of the analyst's coverage universe or an index identified by the analyst that includes, but is not limited to, stocks covered by the analyst.

Sector Outperform (SO)

The stock is expected to outperform the average 12-month total return of the analyst's coverage universe or an index identified by the analyst that includes, but is not limited to, stocks covered by the analyst.

Sector Perform (SP)

The stock is expected to perform approximately in line with the average 12-month total return of the analyst's coverage universe or an index identified by the analyst that includes, but is not limited to, stocks covered by the analyst.

Sector Underperform (SU)

The stock is expected to underperform the average 12-month total return of the analyst's coverage universe or an index identified by the analyst that includes, but is not limited to, stocks covered by the analyst.

Other Ratings

Tender – Investors are guided to tender to the terms of the takeover offer.

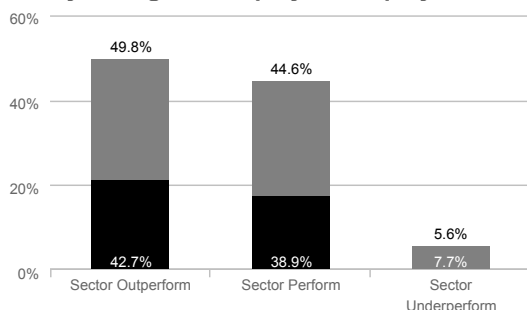
Under Review – The rating has been temporarily placed under review, until sufficient information has been received and assessed by the analyst.

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Scotiabank, Global Banking and Markets Equity Research Ratings Distribution*

Distribution by Ratings and Equity and Equity-Related Financings*



* As of September 30, 2017.

Source: Scotiabank GBM.

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